FIRST APPELLATE DISTRICT, DIVISION FOUR,
NO. A057729 S033123

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

IN BANK

ABBE KANAREK PATTERSON Et Al.,
Respondents

v.

ITT CONSUMER FINANCIAL CORPORATION Et Al.,
Appellants

SUPREME COURT

FILED

Aug. 12, 1993

Appellants' petition for review DENIED.

/s/ LUCAS
Chief Justice

COURT OF APPEAL OF THE STATE OF CALIFORNIA

IN AND FOR THE

FIRST APPELLATE DISTRICT

DIVISION: 4

PATTERSON, ABBE KANAREK, ET AL.
vs.
ITT CONSUMER FINANCIAL CORPORATION ET AL
A057729 Old No. A059641
San Francisco County No. 936818

BY THE COURT:

The petition for rehearing is denied.

Dated: May 3, 1993 /s/ ANDERSON, P.J.

CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIRST APPELLATE DISTRICT

DIVISION FOUR

ABBE KANAREK PATTERSON et al.,
Plaintiffs and Respondents,
v.
ITT CONSUMER FINANCIAL CORPORATION et al.,
Defendants and Appellants.

FILED

Apr. 19, 1993

A057729

(San Francisco Super. Ct. No. 936818)

Defendants, ITT Consumer Financial Corporation, Aetna Finance Company, ITT Lyndon Property Insurance Company, ITT Lyndon Life Insurance Company, and John M. Higgins (collectively ITT), appeal from an order denying their petition to compel arbitration and prohibiting them from confirming arbitration awards in San Francisco County. Plaintiffs Abbe Kanarek Patterson et al., are individuals who borrowed money from defendant finance companies and who, in connection with those loans, purchased insurance policies from defendant insurers.

In September 1991 plaintiffs filed a class action alleging ITT had violated the Consumer Legal Remedies Act (Civ. Code, § 1750 et seq.), engaged in unfair debt collection practices (Civ. Code, § 1788 et seq.), unlawfully made collateral sales a condition upon obtaining loans, breached the loan agreement with respect to insurance payments and refunds, engaged in false advertising, intentionally in-

flicted emotional distress, and committed fraud. A companion case containing many of the same allegations was filed on behalf of an individual plaintiff, John Lang, a few months later.

ITT petitioned for an order to compel arbitration under the following provision which was part of the loan agreement signed by each plaintiff:[1] "You and ITT financial services agree that, other than judicial foreclosures and cancellations regarding real estate security, any dispute, past, present, or future, between us or claim by either against the other . . . whether related to your loan, products you purchase from or through ITT Financial Services, or otherwise, shall be resolved by binding arbitration by the National Arbitration Forum, Minneapolis, Minnesota and judgment upon any award by the arbitrator may be entered in any court having jurisdiction. We agree that the transactions between us are in interstate commerce and this agreement shall be subject to 9 USC § 1-14, as amended."[2]

After a contested hearing the court denied defendant's petitions to compel arbitration, finding that the arbitration clauses were unconscionable and hence unenforceable. The court also ordered defendants not to seek confirmation in San Francisco County of any arbitration awards, but permitted defendants to pursue their claims in San Francisco small claims or superior court actions.

ITT appeals contending that the trial court erred when it found the arbitration agreements to be unconscionable. They also contend that the order prohibiting them from confirming arbitration awards against plaintiffs who were not parties to this action was improper.

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[1] The Lang and Patterson cases were not consolidated but were heard together, apparently because of the common issue presented.

[2] A slightly different version was signed by plaintiff Lang which applies arbitration to "any dispute exceeding $3,000 (including class claims which in the aggregate exceed $3,000)."

Discussion

I. Arbitration Clause

A. Standard of Review

Unconscionability is ultimately a question of law. (*A & M Produce Co.* v. *FMC Corp.* (1982) 135 Cal.App.3d 473, 489.) To the extent that there are conflicts in the evidence or in the factual inferences which may be drawn from the evidence a finding of unconscionability by the trial court will be upheld if it is supported by substantial evidence. (*Ibid.*) If, however, there is no evidence extrinsic to the contract or no conflict in the extrinsic evidence or the conflicting evidence is entirely written, a reviewing court is not bound by the finding of the trial court, but instead subjects the contract to independent review. (*Milazo* v. *Gulf Ins. Co.* (1990) 224 Cal.App.3d 1528, 1534.) In this case what extrinsic evidence there was, was entirely written. Thus, even to the extent that the evidence may be in conflict, this court reviews the arbitration clause de novo.

B. Unconscionability

Two alternative analyses exist under California law for determining whether a contractual provision will be unenforceable because it is unconscionable. (*Perdue* v. *Crocker National Bank* (1985) 38 Cal.3d 913, 924, fn. 8 ["Both [analytical] pathways should lead to the same result."].) The first model set out in *Graham* v. *Scissor-Tail, Inc.* (1981) 28 Cal.3d 807 asks initially whether the contract is one of adhesion. (*Id.* at p. 819.) Since a contract of adhesion is still fully enforceable, the inquiry then turns to whether enforcement should be denied. First, enforcement will be denied if the contract or provision falls outside the reasonable expectations of the weaker party. (*Id.* at p. 820.) Second, enforcement will be denied even if it does fall within the reasonable expectations of the parties, but it is unduly oppressive or unconscionable. (*Ibid.*).

The alternative analytical model was set out in *A & M Produce Co.* v. *FMC Corp., supra,* 135 Cal.App.3d 473. It sought to define what rendered a contract or a contractual provision unconscionable and hence unenforceable under Civil Code section 1670.5. (*Id.* at p. 485.) *A & M* concluded that unconscionability has a procedural and a substantive component. (*Id.* at p. 486.) The procedural component focuses on the factors of oppression and surprise. (*Ibid.*) Oppression results where there is no real negotiation of contract terms because of unequal bargaining power. (*Ibid.*) " 'Surprise' involves the extent to which the supposedly agreed-upon terms of the bargain are hidden in a prolix printed form drafted by the party seeking to enforce the disputed terms." (*Ibid.*) The substantive component of unconscionability looks to whether the contract allocates the risks of the bargain in an objectively unreasonable or unexpected manner. (*Id.* at p. 487.) To be unenforceable there must be both substantive and procedural unconscionability, though there may be an inverse relation between the two elements. (*Ibid.*)

A contract of adhesion is "a standardized contract, which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it." (*Neal* v. *State Farm Ins. Cos.* (1961) 188 Cal.App.2d 690, 694.) The record before us indicates that plaintiffs are individuals of modest means, some self-employed or temporarily jobless, who borrowed relatively small amounts of money, often in response to advertising promising "guaranteed loans." The loan agreement which they signed included a preprinted form containing an arbitration clause either as the final paragraph on a page entitled "Agreement for Dispute Resolution" or at midpage on a sheet of text, but set apart by the use of boldface type. On both versions of the form the provision was clearly titled "Arbitration." None of the preprinted clauses had been modified in any manner which suggests that they were

nonnegotiable. Several of the borrowers stated that they believed they would not have been able to obtain a bank loan. In these circumstances we think it indisputable that the contract was one of adhesion.

ITT argues that arbitration has become such a common means of dispute resolution that it must be considered within the reasonable expectation of the borrowers. While arbitration per se may be within the reasonable expectation of most consumers, it is much more difficult to believe that arbitration in Minnesota would be within the reasonable expectation of California consumers. The arbitration clause says only that the dispute will be "resolved by binding arbitration by the National Arbitration Forum, Minneapolis, Minnesota."

At the time the agreement is signed the borrowers were not given a copy of the procedural rules of the National Arbitration Forum (NAF)—the rules were sent to the borrowers only once ITT had initiated a claim against them. Indeed in her declaration NAF's director of arbitration asserted that "[i]t is not possible for the National Arbitration Forum to advise a claimant or respondent of the location of the Participatory Hearing before a claim is brought or a response entered . . . ." Thus, at the time the agreement was signed even a borrower who inquired about where any arbitration would be held could not have received a definite answer from NAF. Meanwhile the provision on its face suggests that Minnesota would be the locus for the arbitration.

The NAF rules do permit a participatory hearing and state that it "shall be held in the United States federal judicial district or division where the respondent to the initial claim signed the arbitration agreement, *unless the arbitration agreement designates or the parties agree to a different location.*" (Emphasis added.) As the trial court concluded, a reasonable reader of this language might be-

lieve that by signing an agreement to arbitrate with NAF in Minnesota he had in fact agreed to that location.

Under NAF procedures if a borrower responds to notice of a claim with a written denial of responsibility sent to Minnesota, the borrower is found to have conferred jurisdiction on NAF in Minnesota. The result will be an arbitration conducted without appearances by either side and based solely on the submitted documents. Arbitration based solely on documents does not entail payment of fees by the responding party.

In order to obtain a participatory hearing, however, the responding party must make a prompt demand for one and accompany it with prepayment of fees.[3] Prepayment of hearing fees can be waived for individuals, but only after filing an affidavit of indigency. However, the rule explaining the fee waiver process is, as the trial court aptly noted, "incomprehensible," since it requires compliance with rules concerning involuntary dismissals.

The likely effect of these procedures is to deny a borrower against whom a claim has been brought any opportunity to a hearing, much less a hearing held where the contract was signed, unless the borrower has considerable legal expertise or the money to hire a lawyer and/or prepay substantial hearing fees. The latter is especially unlikely given the small dollar amounts at issue. In a dispute over a loan of $2,000 it would scarcely make sense to spend a minimum of $850 just to obtain a participatory hearing. In short the procedure seems designed to discourage borrowers from responding at all. In the event that they do not respond, an award may be entered against them if the documents submitted by ITT support its claim.

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[3] The NAF 1992 fee schedule calls for a filing fee on claims of up to $5,000 of 5 percent but not less than $98. Hearing fees for claims in that dollar range are $750 per three hour session. Additional fees are charged for discovery, written findings and expedited hearings.

While we cannot say that the notice of and implementation of NAF's rules and procedures deny the borrower a "fair opportunity to present his position," they come perilously close to doing so. (*Graham* v. *Scissor-Tail, Inc., supra,* 28 Cal.3d 807, 826.) While NAF's rules and fees might be fairly applied to business entities or sophisticated investors and to claims for substantial dollar amounts, those same procedures become oppressive when applied to unsophisticated borrowers of limited means in disputes over small claims.

Analyzed in *A & M Produce* terms these arbitration procedures bear upon the substantive element of unconscionability. The contractual risk of a dispute resolution process which is weighted heavily against the borrower being able to obtain a hearing seems particularly unreasonable in light of the much greater bargaining power of ITT and its reluctance to disclose even the mechanics of NAF arbitration until it makes an arbitration claim. (*A & M Produce Co.* v. *FMC Corp., supra,* 135 Cal.App.3d 473, 487.)

Moreover, there was evidence in the declarations of several plaintiffs that they had not read the arbitration provision nor had any ITT employee pointed it out to them at the time they signed the loan agreement. While failure to read the provision does not excuse compliance with it (*Madden* v. *Kaiser Foundation Hospitals* (1976) 17 Cal.3d 699, 710), it does establish actual surprise the unfairness of which is reinforced by ITT's failure to call the arbitration clause to the attention of its borrowers. (*A & M Produce Co.* v. *FMC Corp., supra,* 135 Cal.App.3d at p. 490.)

Thus, whether we analyze this arbitration clause as beyond the reasonable expectation of the borrower (in *Graham* v. *Scissor Tail* terms) or as substantively and procedurally unconscionable (under *A & M Produce*'s analysis), the result is the same.

ITT argues that plaintiffs failed to prove the oppression factor of the procedural prong of unconscionability because plaintiffs did not demonstrate that they could obtain loans only from ITT. In support of its position ITT cites *Dean Witter Reynolds, Inc.* v. *Superior Court* (1989) 211 Cal.App.3d 758. In that case a concededly sophisticated investor challenged a $50 termination fee applied to Individual Retirement Accounts (IRA). The court held "that the 'oppression' factor of the procedural element of unconscionability may be defeated, if the complaining party has a meaningful choice of reasonably available alternative sources of supply from which to obtain the desired goods and services free of the terms claimed to be unconscionable." (*Id.* at p. 772.) In *Dean Witter* the "record establish[ed] without conflict that other financial institutions offered competing IRA's which lacked the challenged provision." (*Id.* at p. 771.) The court concluded that the investor had completely failed to prove the procedural prong of unconscionability—there was no oppression since other entities offered an IRA without a termination fee, and there was no surprise since the fee had been disclosed to a sophisticated individual who would have understood the disclosure. (*Id.* at p. 771-772.)

Such is not the case here. These plaintiffs were individuals of modest resources who believed they would not have qualified for a conventional loan from a bank. Moreover, they were not purchasers of an IRA account, but applicants for a loan, many of whom were responding to advertisements from ITT for "guaranteed loans." There is nothing in this record to suggest that plaintiffs had a "meaningful choice of reasonably available alternative sources" of personal loans from lenders who would not require NAF arbitration.

We conclude that the arbitration provision in the loan agreement is unconscionable and thus unenforceable.

II. Order

At the time the petition to compel arbitration was denied plaintiff had filed a complaint on behalf of a class of similarly situated consumers, but as yet no class had been certified. Meanwhile ITT had pending in San Francisco Superior Court a number of petitions to confirm arbitration awards against potential members of the class. As the trial court stated, "ITT Consumer Financial Corporation has been filing its claims with the NAF in Minneapolis, MN, taking Defaults therefrom, based either upon borrowers' failures to appear or failures to respond to the NAF notice, then enforcing the Arbitration Awards in the Law and Motion Department of this Court by having them confirmed into California judgments."

In response to this practice and at the urging of plaintiffs' counsel that the court take some measure to enforce its ruling as to all ITT borrowers, the court issued an order directing ITT to refrain from seeking to confirm NAF arbitration awards taken by default. The order does permit ITT to pursue delinquent borrowers in San Francisco courts; thus ITT can pursue in judicial actions new claims or NAF arbitrated but as-yet-unconfirmed claims.[4]

ITT makes two arguments that the order is infirm. First, it contends plaintiffs had no standing to object to confirmation of arbitration awards against borrowers who were not named plaintiffs in this action. Second, it contends

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[4] The order further provides that a consumer against whom ITT files an action in a San Francisco court may not assert the arbitration agreement in order to obtain a stay of the court proceeding, nor may the consumer base a claim for wrongful conduct of ITT's failure to arbitrate. In recognition that a class was not yet certified, however, the court permitted any consumer not presently a plaintiff to ignore the order and assert the arbitration clause. In such an event the order directs that ITT shall not be penalized by having instituted a court action in compliance with the order.

that the order is overbroad and unnecessary under California law.

The standing of the plaintiffs is not really the issue. ITT objects that the order prohibits it from reducing *any* NAF default arbitration awards to judgment, not just those it might obtain against the named plaintiffs against whom it was seeking to compel arbitration. ITT ignores the fact that the *Patterson* case is plead as a class action.

Once jurisdiction over a matter is conferred upon a trial court it has all means necessary to carry its jurisdiction into effect. (Code Civ. Proc., § 187; *People* v. *Gonzalez* (1990) 51 Cal.3d 1179, 1257.) In addition to this general grant of authority courts are also authorized to issue temporary restraining orders and/or preliminary injunctions in class actions even before the class has been certified. (Code Civ. Proc., § 527.) Obviously, in this instance the order which issued arose in the context of a motion to compel arbitration, but that procedural happenstance does not act to deprive the court of authority to issue an order effectuating its conclusion that the arbitration clause is unenforceable, especially where there is a class action pending which potentially includes all California ITT borrowers. The order which issued was tailored to protect ITT's collection rights, but at the same time to permit plaintiffs to seek class certification. We conclude it is not overbroad.

Disposition

The order denying ITT's petition to compel arbitration and prohibiting it from confirming NAF default awards in San Francisco County is affirmed.

Poche, Acting P.J.

WE CONCUR:

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Perley, J.

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Reardon, J.

SUPERIOR COURT OF THE STATE OF CALIFORNIA

IN AND FOR THE CITY AND COUNTY OF SAN FRANCISCO

Case Nos. 936818 and 939316 (Actions not consolidated.)

ABBE KANAREK PATTERSON, ET AL.,
Plaintiffs,

v.

ITT CONSUMER FINANCIAL CORPORATION, ET AL.,
Defendants.

JOHN LANG,
Plaintiff,

v.

ITT CONSUMER FINANCIAL CORPORATION, ET AL.,
Defendants

FILED

MAY 19, 1992

[PROPOSED] ORDER DENYING DEFENDANTS' PETITIONS TO COMPEL ARBITRATION

On April 29, 1992, the Court held a hearing on these two non-consolidated actions. Defendants appeared by Sara Church Dinkler and Carey Linkon of Gibson, Dunn & Crutcher and John W. Cotton and Aaron C. Gundzik of LeBoeuf, Lamb, Leiby & MacRae. Plaintiffs appeared by Patricia Sturdevant and Kim E. Card of Sturdevant & Sturdevant and Brian Newcomb. Before the Court were defendants' Motion for Reconsideration of the Court's Or-

der Denying Petitions to Compel Arbitration and the Court's own proposed order to prohibit defendants from seeking, in San Francisco County Courts, confirmation of arbitration awards rendered by the National Arbitration Forum ("NAF"). After reviewing the briefs of the parties and entertaining oral argument, the Court entered the following Orders:

The Court grants defendants' Motion for Reconsideration and reviews its previous order in light of the evidence presented by defendants in their moving papers.

The Court finds the arbitration clauses unconscionable and denies defendant's petition to compel arbitration. The Court makes the following findings in respect thereto:

1. The arbitration clauses are printed on form contracts which are part of the transactions in which borrowers in the main borrow small amounts of money and are unrepresented by counsel; there are two different versions of arbitration clauses before the Court which differ slightly from each other depending on the date of the form contract in questions. Both versions are equally unconscionable for all of the reasons stated herein;

2. The arbitration clauses are neither negotiated nor negotiable;

3. A fair reading of the arbitration clauses is that any arbitration hearing is to be conducted at the NAF offices in Minneapolis, MN;

4. The borrowers are not given a set of NAF Arbitration Rules when they purportedly agree to be bound by these Rules by signing the loan document, but only after a claim is filed by ITT;

5. The Rules contain no intelligible, readily understandable notice to the borrower that an Arbitration Hearing may be had in the locale where the loan was signed; the NAF Rules as published in 1989 and 1992 contain ex-

tremely confusing directions to the borrower as to the manner in which a borrower may attempt to elect San Francisco, CA. as the site for a contested Arbitration hearing. The Arbitration Rules suggest that the Arbitration may be in the Federal Judicial District where the loan was signed by the borrower "unless the arbitration agreement designates or the parties agree to a different location." (NAF Code of Procedure Rule 32 (1992).) This language leads the borrower to believe that by signing the loan document which contains the Arbitration Clause he or she has already "otherwise agreed" to have the hearing in Minneapolis, MN;

6. The language of the Rules of the NAF regarding the waiver of the considerable fees for a participatory hearing is incomprehensible, in that the Rules speak of mandatory compliance with the standards of NAF Rules 41A and 41B which have nothing to do with fees;

7. Assuming that a borrower could divine the waiver of fees provisions, in order to avail himself or herself of them a borrower must file an affidavit of poverty, an act which is not acceptable to the average borrower and which discourages the use of such provisions. Moreover, such fee waivers are available only to those borrowers who are actually impoverished.

8. When a claim is filed by ITT before the NAF in Minneapolis, MN, a notice is mailed to the borrower by NAF suggesting that he or she contact NAF to assert any defenses he or she may have to the claim; defendant ITT concedes that the legal effect of such assertion of defenses would be to confer jurisdiction on NAF in Minneapolis, MN;

9. In practice, ITT Consumer Financial Corporation has been filing its claims with the NAF in Minneapolis, MN, taking Defaults therefrom, based either upon borrowers' failures to appear or failures to respond to the NAF notice, then enforcing the Arbitration Awards in the Law and

Motion Department of this Court by having them confirmed into California judgments.

10. In light of the Court's finding that the arbitration agreements are unconscionable, the Court further orders that Defendants are to refrain from seeking to confirm arbitration awards, pursuant to California Code of Civil Procedure section 1285, in San Francisco County Superior Court, where the arbitration award was rendered by the National Arbitration Forum or any of its arbitrators, either by default or administrative order;

11. Defendants shall refrain from taking any actions towards seeking Court approval, in San Francisco County Superior Court, of all petitions to confirm arbitration awards that are currently pending.

12. Subject to paragraph 18 of this Order, because defendants are unable to confirm, in San Francisco County Courts, arbitration awards that are rendered as a result of the arbitration agreements between them and their customers, defendants shall be permitted to file and pursue in the San Francisco County court that would otherwise have jurisdiction over such claim, any claim they have against any customer, notwithstanding the existence of a signed arbitration agreement with that customer;

13. At their option, defendants may withdraw all petitions to compel arbitration that are currently pending in the San Francisco County Superior Court and reassert the claims upon which those arbitrations were based in the San Francisco County court that would otherwise have jurisdiction over that claim.

14. Subject to paragraph 18 of this Order, in the event that defendants file any claim against any customer in any San Francisco County court pursuant to Paragraphs 12 and 13 of this Order, the customer may not assert the existence of the arbitration agreement in order to have the action stayed in the San Francisco Court. Moreover,

no customer against whom a claim has been filed in this court, as authorized by this Order, may assert that defendants' failure to arbitrate pursuant to the arbitration agreement constitutes an unfair debt collection practice or other wrongful or tortious act.

15. Subject to paragraph 18 of this Order, no customer or member of plaintiffs' proposed class may argue that defendants have waived their right to arbitrate claims against such persons because defendants have complied with Paragraphs 12 and 13 of this Order by filing a claim in the San Francisco courts.

16. Defendants' utilization of the San Francisco courts to assert claims against customers who have signed arbitration agreements is being done solely for the purpose of complying with this Order. Consequently, this Court finds and holds that defendants' utilization of the courts to enforce claims, as opposed to arbitration, does not constitute any waiver of defendants' ability to seek arbitration in other actions against other customers not covered by this order.

17. This order is effective April 29, 1992.

18. No class has yet been certified. The Court recognizes that Defendants' customers against which it wishes to assert claims are only potential members of a potential plaintiff class and, except for presently named plaintiffs, are not before this Court at this time. Accordingly, notwithstanding anything herein contained to the contrary, any such customer not before this Court shall have the option to elect to disregard this Order, and to respond to any court claim filed by Defendants by asserting the arbitration clause. In any such case, as to any such customer or customers so electing, paragraphs 12, 14 and 15 hereof shall not apply; no act of Defendants in reliance on this Order in having utilized the San Francisco courts to initiate claims against any such electing customers shall inure to the benefit of any such electing customers nor to the

detriment of Defendants in respect of any such claims, and in all respects the rights of the parties shall be unaffected by the filing of any such claims by Defendants in the San Francisco courts.

Dated: May 19, 1992 /s/ Laurence D. Kay
The Honorable Laurence D. Kay
San Francisco County Superior
Court Judge